



**RECOMMENDATIONS OF
THE BLUE RIBBON PANEL ON HOUSING FINANCE
OF THE CITY OF BOSTON**

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MARCH 2002

**MAYOR THOMAS M. MENINO, CITY OF BOSTON
MARK MALONEY, BOSTON REDEVELOPMENT AUTHORITY**

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Background

The City of Boston is facing a housing crisis unmatched in recent times. Boston has witnessed an influx of new residents employed in the downtown office market, a decline in household size, and an aging housing stock, all of which are combined with a decrease in new residential construction. Since 1995, housing prices have increased at twice the rate of income growth in the Boston metropolitan area. Young and old alike are finding it difficult to remain in the neighborhoods they call home.

The issue of housing in the City of Boston has been a primary concern of Mayor Thomas M. Menino's Administration. In order to present a clear agenda for the future, in October 2000, the Mayor released *Leading the Way*, a report that detailed Boston's housing strategy through 2003. The City's Department of Neighborhood Development ("DND"), the Boston Housing Authority ("BHA"), and the Boston Redevelopment Authority ("BRA") pledged to work together to encourage the construction of 7,500 new units of housing during this three-year period, with contributions such as \$30 million of City funds and 5.5 million square feet of City-owned land.

One proposal set forth within *Leading the Way* was the convening of a Blue Ribbon Panel on Housing Finance. The Panel would consider new public and private mechanisms to support the construction of market-rate and affordable housing in the City of Boston and the Commonwealth of Massachusetts. The Panel would generate new housing finance options and would be invited to assist in the implementation of these recommendations through discussion and negotiation with key lending institutions. The Panel would explore specific tools: City, State, and Federal resources; private resources; tax incentives and initiatives; and, bonding options.

In May 2001, Mayor Menino asked Nicolas Retsinas of Harvard University's Joint Center for Housing Studies and Jay Sarles of FleetBoston Financial to co-chair a Panel of experts drawn from the fields of residential development and real estate finance. These experts were selected from the private, non-profit, and public sectors and from throughout the northeast United States. The Panel met over six months both as a whole and within smaller, topical committees.

In fulfilling its mission, the Panel focused on identifying achievable changes that could lead to practical programs.

The Approach of the Panel

In this report, the Blue Ribbon Panel on Housing Finance outlines its recommendations in four general categories distinguished by implementation agent: the City; Public/Private Partnerships; the State; and, the Federal government. In each of these categories, the Panel provides specific suggestions for the appropriate level of government to quickly mobilize both public and private resources toward the creation of new housing. The recommendations provide a vehicle for accomplishing immediate tasks, while laying the groundwork for the future creation of a comprehensive production program that clarifies and streamlines residential development in Boston and throughout the nation.

In addressing the Panel's fundamental motivation to create financial opportunities for new housing construction in Boston and the surrounding communities, the members looked to a range of housing prices and types including market-rate, luxury, and affordable units, and single-family and multifamily housing. The Panel acknowledged that the construction of new housing is essential both for the social cohesion of the neighborhood communities of Boston and the economic needs of the downtown employers. The members sought to overcome the limitations of the current residential financing environment due in part to constrained private sector capital, restricted public capital, and complicated timing and coordination requirements. While the Panel supports the creation of housing for all income groups, some of the recommendations explicitly aid the construction of affordable units due to government's primary responsibility to create opportunity for those who are economically vulnerable.

Recommendations of the Blue Ribbon Panel on Housing Finance

The City of Boston

The City of Boston must send a clear message to housing developers and financiers that Boston is open to new residential development. City support is crucial to any real estate project, and the City has an obligation to improve policies, processes, and programs to assist in the creation of new residential units.

The City should give competitive treatment for any housing with permanently affordable units by adopting formal guidelines for tax assessment consistent with Massachusetts tax code.

Although the City Assessing Department has previously recognized the reasonableness of giving special consideration to multifamily buildings with affordable units, formal guidelines do not exist which would give developers, lenders, and equity providers predictable property valuation over an extended

period. In order to provide a standardized approach and year-to-year stability in the assessment of these properties, the Assessing Department should adopt and publish guidelines that include the following:

- Recognition that affordable units will initially have lower rents, and those rents will not necessarily increase with market conditions;
- An assumption that the expense ratio associated with affordable units will be higher than that of luxury units; and
- A capitalization rate increase reflecting the impact of affordability restrictions on the rate of return expectations of an investor and the impact affordable units will have on the resale value of a property.

Guidelines such as these will allow for a decreased valuation for affordable developments and therefore result in a lower tax assessment. Recognition of lower rents and a higher expense ratio indicate less income over time, while an increased capitalization rate results in lower value calculation and therefore lower tax payments for market units in mixed-income properties. In one example provided by Rose Associates, Inc., the difference in a standard-size apartment building was as much as \$163,196.50 in taxes or \$668 in taxes per unit. These guidelines should be easily accessible to all parties interested in residential development in Boston, including access through the City of Boston web site.

Next Step(s): By August 2002, the City Assessing Department will release new guidelines for the taxation of affordable housing developments.

The City should revise the existing zoning code to allow additional as-of-right housing development opportunities.

In light of the difficult financing market for residential development, profitable and thus financeable projects often require greater size. Boston zoning encourages size primarily in the downtown, however this area is generally zoned with floor-area ratios and heights that support commercial uses. Since residential buildings are usually of less mass, but require greater height to achieve economic feasibility, a residential project sometimes becomes impossible without complicated zoning relief.

The Panel recommends that the City examine existing zoning restrictions throughout Boston to identify appropriate areas for housing where zoning currently makes residential development cost prohibitive. Height limitations in these areas should be eased to accommodate slender residential towers. While downtown zoning is generally mixed-use, upper-floor residential development in retail commercial districts such as Downtown Crossing and the Bulfinch Triangle should be strongly encouraged. In the neighborhoods, some densities allowed under the existing zoning code must be increased to accommodate new housing development. One positive program currently

under coordination by the BRA is the Transit-Oriented Development planning initiative that allows greater densities around public transit areas. The Panel realizes that this process will require careful planning and community involvement.

Next Step(s): By August 2002, the BRA will recommend zoning modifications, including possible incentives, to encourage residential development in the downtown or other high-density areas.

The City should provide a Community Development Block Grant ("CDBG") float in order to realize income on the dollars before they are expended for designated purposes.

To maximize the yield of tax credits, the City of Boston should use its CDBG float to provide interest-free equity bridge loans to developers for the period of closing through construction completion.

CDBG float refers to block grant funds that have been awarded to the City but have not been committed to a project, and/or have been committed but have not been drawn down from the U.S. Department of Housing and Urban Development ("HUD"). HUD permits these float funds to be used for an interim CDBG-eligible purpose on the condition that the funds are fully secured by an unconditional letter of credit or like instrument.

By insulating the investors from the period of greatest risk for their investment, the float loan permits the transaction to attract an increased syndication yield. Recent experience indicates that the value of such a bridge loan is in the range of 10% of the net yield. In Fiscal Year 2002, approximately \$2.3 million was available for float. Moreover, since the real estate industry is accustomed to providing partial bridge loans against equity income, underwriting for the letter of credit, which will be secured by investor notes, will not require lenders to assume new or additional risk. However, it will reduce the transaction and carrying costs of the project.

Next Step(s): By August 2002, the City's Chief of Housing will work with City departments and agencies to identify ways to maximize the use of the CDBG float.

Public/Private Partnerships

While government has a key role in encouraging residential development, the City must also send a call for action to its traditional community partners including businesses, institutions, non-profits, and even residential organizations. The City can serve as facilitator, leveraging its powers to engage the private sector to support public priorities. Private partners could contribute in various ways, whether through financial assistance, provision of land, or provision of services.

The City should engage with local financial institutions, including government-sponsored enterprises (“GSEs”), to identify new opportunities for public/private cooperation for residential development.

Boston is one of the top cities in the world for financial services, with a plethora of banks, securities firms, and other money management businesses. These firms are dependent on the educated workforce of Boston, and must be concerned with the rising price of housing in the City due to inadequate supply. While already working with the residential development community, the financial industry must join with the City to provide new resource opportunities. A public/private partnership between the City and local financial institutions could lower risk, increase transparency, and improve the process by which public and private dollars are spent to support residential development. Such outcomes would allow for an increase in resources devoted to residential development in Boston from both local and national financial institutions. The involvement of GSEs such as the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) as well as local organizations and agencies such as the Massachusetts Housing Partnership and the Massachusetts Housing Investment Corporation is critical.

Next Step(s): By August 2002, the City will inventory and, as appropriate, identify additional public/private opportunities for coordination with financial institutions.

The City should engage with local educational, medical, and religious institutions to identify new opportunities for public/private cooperation for residential development.

An inherent part of Boston’s strength is the diversity of its economic base including its major institutional employers. These corporations, in addition to bringing social and economic diversity, employ and serve large numbers of people and, in the case of the universities, attract a large population of young students. An inadequate supply of on-campus housing has forced many students into off-campus rental housing, increasing the demand for and thus the cost of the neighborhood housing supply.

Institutions must be engaged on issues of local concern. By their nature, institutions are usually intricately associated with their local community and have less flexibility to relocate. Many of these institutions and employers, especially Boston’s largest universities, have worked closely with the City to accommodate growth. Institutional Master Plans allow the City and the university to plan and prepare for new and existing students, resulting in over 10,000 new dormitory beds on Boston campuses in the 1990s. Linkage payments by institutions and new developments have helped create new units

of affordable housing throughout the City. Projects like Northeastern University's Davenport Commons – part dormitory and part homeownership housing development – are models for accommodating institutional and neighborhood needs. Religious institutions, too, have the power to effect major development, as evident in the construction of nearly two hundred units of housing at Rollins Square in the South End by the Archdiocese of Boston. The Panel believes that institutions and employers could be even better partners to approach this shared dilemma of improving the availability and easing the cost of housing in Boston.

The Panel encourages joint development of rental housing by local institutions and private sector developers. One potential is a contribution of land (e.g., in the form of a long-term, unsubordinated ground lease) by institutions for some economic return on the land plus some residual value in the overall project. The benefit of this concept is an immediate reduction in project costs for residential developers. The City for its part should consider allowing increased density and mixed-use on the sites chosen. Office or classroom space in the lower floors with apartments above is one possibility. Another option for institutions is the creation of a funding source to bridge the gap of required equity and guarantee during the construction and development phase of each project. Should the issues raised conceptually by joint development be surmounted, there remains a large equity requirement and guarantees during construction. Payment In Lieu of Taxes ("PILOT") agreements should be amended as institutions expand.

Next Step(s): By August 2002, the City will inventory and, as appropriate, identify additional public/private opportunities for coordination with educational, medical, and religious institutions.

The City should engage with the local business community to create employer-assisted housing ("EAH") for the workers of Boston.

Affordable housing costs are a key element of a local company's ability to attract and retain a qualified workforce. The Greater Boston Chamber of Commerce ("Chamber"), a broad-based organization representing 1,800 businesses, is exploring employer-assisted housing initiatives and their implications for Boston business. The Chamber is working with Fannie Mae to identify employer-assisted initiatives to promote among its members.

EAH programs assist employees in a diversity of ways. Ideas are as complex as private businesses joining as equity partners or assisting local nonprofits with the acquisition, development, or rehabilitation of affordable housing, or as simple as providing residential counseling and program referral through Human Resource departments. Other ideas include guarantees or soft second loans.

The City should extend its assistance and expertise to the Chamber and should work with employers throughout the City to identify opportunities for housing creation and employee financial support.

Next Step(s): By August 2002, the BRA will further its discussions with the Greater Boston Chamber of Commerce task force on EAH initiatives to identify potential employer-assisted or GSE housing opportunities.

The City should engage private foundations throughout Boston and the United States to assist in the creation of affordable housing opportunities.

Last year, over 50,000 foundations around the United States gave an estimated total of \$27.6 billion in grants for a wide variety of causes. Foundation assets topped \$448 billion in 1999, up more than 16% from 1998. In Boston alone, the three largest foundations – Barr Foundation, Boston Foundation, and Fidelity Foundation – hold nearly \$2.4 billion in combined assets and distributed nearly \$100 million in grants in 1999. The sale of the Boston Red Sox results in hundreds of millions of new dollars endowing the Yawkey Trust. According to The Foundation Center, over \$300 million in grants were awarded in the Boston metropolitan area in 1999.

The City should work with private foundations, both within and without Boston, to generate foundation assistance for the creation of new affordable housing. The Panel proposed several possible funding opportunities. Foundations could pool funds to provide grants or low- or no-interest loans to both developers and buyers/tenants. They could provide equity investment. They could write down the cost of private loans or could purchase linkage payment streams in order to grant the Neighborhood Housing Trust the early use of exaction dollars. They could purchase land for the development of housing. Foundations could fund the study of housing issues affecting cities, using Boston as a model, and propose specific programs for resolution of the housing crisis. If possible, these programs should not compete with existing foundation programs supporting the homeless and other human service projects.

Next Step(s): By August 2002, the City will work with foundations to identify opportunities for foundation involvement in supporting the construction of new housing in Boston.

The City should work with the State to advance the housing goals of the Community Preservation Act (“CPA”) or develop a new program of similar intergovernmental cooperation that generates funds for housing in a dense urban context.

The Panel recognized that the CPA could have been an important boost to the resources dedicated to housing, open space, and historic preservation. Discussion of the referendum in Boston, however, highlighted clear issues related to appropriateness, balance, and impact in an urban context. As a city that depends primarily on property taxes as its revenue source, Boston needs state matching funds, such as those available from the State Community Preservation Trust Fund. Unlike most cities in Massachusetts, Boston’s commercial real estate currently shoulders approximately 70% of the property tax burden. In addition, some businesses are already contributing to affordable housing in the form of linkage payments and may soon be contributing to open spaces along the Central Artery corridor. A program like the CPA must be considered within a comprehensive strategy to minimize costs affecting land values in Boston.

The Panel recommends that the City use this opportunity to start broader discussions immediately with the State to advance the housing goals of the CPA. A modified CPA would raise funds locally but from more diverse sources, and it would also offer State matching grants for housing as available under the original CPA. If modification proves unfeasible, the Panel recommends the City seek support for new legislation or draft a home rule petition that would allow the City to maintain the goals of the CPA without the limitations inherent in the original CPA.

The City should convene neighborhood residents and representatives of the business community to ensure that this program equitably shares the burden of housing production while fully considering local needs and concerns.

Next Step(s): By August 2002, the City will outline and implement a plan for advancing the housing goals of the CPA for the City of Boston or will outline and implement a plan for achieving new legislation or approval of a home rule petition similar to the CPA yet with greater flexibility for funding generation and distribution.

Commonwealth of Massachusetts

The Panel calls on the State to commit itself to residential development. While recent legislation recognizes the growing importance of housing needs throughout the Commonwealth, the State must commit more resources to make residential development a more attractive investment. The Panel calls on the State to create more programs and to allocate more resources for use by both public (i.e., City/BRA) and private development interests.

State tax-exempt financing mechanisms should increase their commitment to housing construction.

Tax-exempt financing is often a necessary component of any large-scale mixed-income development program. In addition to benefiting from a lower interest rate, tax-exempt financing for rental housing defined by the federal government as “private activity” automatically makes a development eligible for the four-percent low-income housing tax credit on the cost of the low-income units.

The Federal government annually allocates \$463,000,000 of tax-exempt bonding authority to the Commonwealth. The Executive Office of Administration and Finance (“A&F”) allocates 30% of this amount each to the Massachusetts Housing Finance Agency (“MassHousing”), Massachusetts Development Finance Agency (“MassDevelopment”), and the Massachusetts Health and Educational Facilities Authority (“MEFA”). The remaining 10% is held back by A&F. In addition, there is no federal or state dollar limit on tax-exempt financing in Massachusetts for qualified housing projects developed by 501(c)(3) nonprofit organizations, though in choosing this route such projects are not eligible for four-percent tax credits. Non-profit organizations electing to apply for the four-percent tax credits are subject to the bond volume cap.

Of the approximately \$140,000,000 of tax-exempt bonding authority received by MassHousing, \$100,000,000 is allocated for multifamily housing and \$40,000,000 for single-family units. Of the multifamily housing allocation, between one-half and two-thirds is allocated to Boston projects. The financing is almost exclusively for the acquisition and rehabilitation of “at risk” assisted developments. These numbers are in jeopardy, however, as MassHousing predicts growing demand for tax-exempt financing for non-Boston new construction making it difficult for the agency to increase or even maintain Boston’s traditional allocation.

MassDevelopment allocates a small percentage of its bonding authority for housing, primarily assisted-living and developments involving the disposition of state-owned land. While economic development is an obvious and essential role of MassDevelopment, it should, where appropriate, support the housing programs proposed for the state-owned properties transferred to the agency for disposition. Additionally, the State and its agencies, the City, and the BRA are working on an agreement whereby the BRA would serve as disposition agent for certain State properties in Boston. This agreement would encourage the development of housing on key locations in Boston’s neighborhoods. MassDevelopment should work with the BRA to commit State dollars to assist in these developments.

The Panel calls on the State to increase the bond cap for housing and to allocate more resources toward housing efforts. Highlighting pending legislation granting MassDevelopment control of State properties for disposal as housing, the Panel recommends that MassDevelopment dedicate more resources to help fund residential projects on these sites. The Panel also recommends that A&F allocate a portion of the holdback for use in new multifamily residential construction.

Next Step(s): By August 2002, the State should identify sources of additional revenue for housing and should dedicate a portion of the holdback toward new multifamily residential construction currently in the funding pipeline. MassDevelopment should work with the City and the BRA to identify and begin disposition of state-owned parcels in Boston for housing development.

The State should adopt the Tax Increment Financing proposal currently under consideration by the legislature, with minor amendments.

The two chambers of the Massachusetts General Court have approved differing versions of a bill that would extend a form of tax increment financing (“TIF”) to housing. Under the legislation, a city or town could grant a real estate tax exemption for the development of properties for residential or mixed-use. The legislation will also enable cities and towns to establish districts within which the tax increment associated with increasing property values may be captured to support new public and private development. In order for a project to qualify for a tax exemption, at least 25% or 50% of the units developed, depending on the version of the bill, must be affordable to those with incomes at 80% of the area median. The Panel endorses the TIF, but proposes the following modifications to the legislation:

- Make the entire cost of the project (not just the cost of the affordable units) eligible for the enhanced investment tax credit (“ITC”).
- Extend the enhanced ITC to projects that receive other types of local financial assistance, including 121A projects, abatements of unpaid back taxes under Section 8 of Chapter 58 of the General Laws, etc.
- Clarify how a mix of uses can be accommodated in the tax increment program.
- Create the Urban Housing Center Zone Improvement Fund, as described in the House version of the bill.
- Allow for the creation of districts that include single projects, as described in the Senate version of the bill.

Next Step(s): By August 2002, the State should enact new TIF regulations incorporating the above modifications. Upon passage of a final bill and approval by the Governor, the BRA and Assessing Department will outline a TIF program for the City of Boston.

Federal Government

The Panel calls on the Federal government to renew its commitment to housing and to support State and Local efforts to encourage residential development. The high cost of housing is a national crisis, and only the Federal government has the necessary resources to comprehensively approach the issue. Nevertheless, Federal spending on housing has declined in the last few decades. From a high of 7.5% of the Federal budget in 1978, housing has dropped to only 1.5% today. Federal policymakers must refocus Federal attention and dollars on housing. Federal officials should work with State and Local organizations such as the National Governors' Association and the U.S. Conference of Mayors (of which Mayor Menino is president-elect) to identify State and Local needs and provide appropriate resources.

The Massachusetts Congressional delegation should work to obtain a further increase in statutory mortgage limits that will make Federal Housing Administration ("FHA") insurance useable in the Boston area.

FHA insurance lessens risk to lenders who provide mortgage loans to low- and moderate-income residential purchasers. It was historically critical to the development of multifamily housing in Boston. Most of Boston's larger multifamily developments were initially FHA insured (e.g., Charles River Park, Greenhouse, Devonshire, Jamaica Towers).

There is huge demand for FHA insurance throughout the country. For the last several years, FHA insurance has not been useable in the Boston area due to the federal statutory mortgage limits. The statutory limits are \$41,536 for low-rise and \$45,583 for high-rise apartments. In high cost areas, the limits can be increased by 240%. Other permissible adjustments (e.g., "costs not attributable") can raise the limits somewhat further (another 10% to 20%).

Until December 2001, the FHA insurance limits had not been increased in over a decade. The recent increase of 25% does not go far enough to accommodate the high cost of housing in the nation's more expensive cities.

To be useful in the Boston area (and other high cost areas), the limits should have been increased by at least 60% (or the high cost limits increased above 240%). This would have allowed FHA insurance to again be a useful tool in the development of multifamily housing in Boston.

Next Step(s): By August 2002, the Massachusetts Congressional delegation should submit, and potentially secure passage of, a bill to increase the statutory mortgage limits for FHA insurance as applicable to Boston.

Conclusion

In August 2002, the Panel shall reconvene to mark progress made toward achieving the goals of the recommendations outlined within this document and especially the accomplishment of the indicated Next Steps.

These recommendations of the Panel are not meant to be comprehensive but are intended to be targeted approaches for overcoming the sometimes difficult hurdles related to residential real estate financing.

These recommendations lay the groundwork for the creation of a true production program for new housing. A production program would provide a unified approach for developers from generation of plans, purchasing of properties, obtaining necessary permits, and securing necessary financing.

Boston needs more housing and only the coordinated efforts of the public and private sectors can ensure that the right housing is constructed in the right timeframe. The Panel pledges its efforts to see these recommendations achieve fruition. It calls on City, State, and Federal leaders to do the same.

Blue Ribbon Panel on Housing Finance

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